Calendar No. 877

100TH CONGRESS *2d Session*	SENATE	REPORT 100-461

INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF 1988

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2544

AUGUST 8, 1988.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
19-010 WASHINGTON : 1988

S243-7

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AUGUST 8, 1988.—Ordered to be printed

Mr. PROXMIRE, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 2544]

INTRODUCTION

The Senate Committee on Banking, Housing, and Urban Affairs, to which was referred this bill (S. 2544), to amend the federal securities laws to facilitate cooperation between the United States and foreign countries in securities law enforcement and to provide the Securities and Exchange Commission with authority to impose employment restrictions on securities professionals based upon misconduct in foreign countries, reports favorably thereon and recommends that the bill do pass.

PURPOSE OF THE LEGISLATION

The major purpose of S. 2544, the International Securities Enforcement Cooperation Act of 1988, is to address the problem of international securities fraud. In recent years, a growing number of Securities and Exchange Commission ("Commission" or "SEC") investigations have involved suspicious conduct, taking place in foreign countries, which have an impact on the U.S. securities markets. In many of these cases, the Commission has found it difficult to collect evidence that is located abroad. Title I of this legislation would facilitate the gathering of such evidence by promoting cooperation among international securities authorities.

Title I would amend Section 21(a) of the Securities Exchange Act of 1934 ("Exchange Act") to provide that the Commission may, at the request of its counterpart in a foreign country, require persons or entities located in this country to produce evidence relating to a

potential violation of the foreign country's securities laws when that foreign counterpart agrees to provide the Commission with similar assistance. At the present time, the Commission lacks such investigative authority, and can compel the production of documents and evidence only when it appears that a violation of the U.S. securities laws may have occurred.

The Committee anticipates that, if this legislation is enacted, the SEC and its foreign counterparts will enter into evidence-gathering agreements which expressly provide for mutual investigative assistance. Indeed, two such agreements, which are known as memoranda of understanding or MOU's, were reached earlier this year. Those MOUs, one between the SEC and the securities commissions of Ontario, Quebec and British Columbia, and another between the SEC and the Brazil Comissao de Valores Mobiliarios, provide that, once legislation such as S. 2544 is enacted, the SEC may assist the foreign commissions in gathering evidence in a securities law investigation. The Commission has previously entered into MOUs with Switzerland, the United Kingdom Department of Trade and Industry, and the Japan Ministry of Finance. These agreements provide for the exchange of information between authorities, but do not require that a signatory may, at the request of the other signatory, provide investigative assistance. The Committee believes that, in this important area of securities law enforcement, the Commission should have the authority to expand these existing MOUs, and to enter into additional MOUs with other foreign countries, so as to provide for mutual investigative assistance.

Title I also would amend the Exchange Act to enable the SEC to maintain the confidentiality of certain foreign evidence. In some cases, foreign authorities have been willing to share confidential information with the SEC, but are unwilling to permit the SEC to make such information public. Indeed, under some foreign laws, it is illegal to make certain confidential information public. Under U.S. law, however, the SEC is governed by the Freedom of Information Act, 5 U.S.C. 552, which, unless certain specific exemptions are satisfied, may require disclosure of documents regardless of their confidential status under foreign law. In order that the SEC might be able to obtain otherwise unobtainable confidential documents from foreign countries for law enforcement purposes, the Committee believes that it would be appropriate to carve out a narrow area in which the Freedom of Information Act would not apply.

In addition, Title I would make explicit the SEC's rulemaking authority to provide documents and other information to foreign authorities, as well as to domestic authorities. There are certain provisions of the federal securities laws which arguably preclude the public disclosure of certain nonpublic documents upon request. In view of the significance of this issue to the Commission's efforts to cooperate both with foreign and domestic securities officials, legislation is needed that would provide appropriate relief from these nondisclosure provisions.

Title II of S. 2544 addresses the problem of misconduct by brokers, dealers and other professionals who operate in the international securities markets. Title II would provide the SEC with the authority to censure, revoke the registration of, impose employment restrictions upon a securities professional who is found by a

foreign court or foreign securities authority to have engaged in illegal or improper conduct. The SEC explicitly has authority as to findings of illegal or improper activity in this country, but its authority as to improper activity abroad is limited. S. 2544 would provide the SEC with the authority to impose sanctions on or prevent U.S. registration of securities professionals who have been found to have engaged in misconduct abroad when, had the same misconduct taken place in the United States, the professional would have been subject to an SEC disciplinary proceeding.

The legislation has the full support of the Departments of State and Justice.

HEARINGS

The Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs held hearings on the legislation on June 29, 1988. Testimony was received from David S. Ruder, Chairman of the SEC, and Mary Mochary, Principal Deputy Legal Advisor of the Department of State. In addition, written testimony in support of the legislation was submitted by Mark M. Richard, Deputy Assistant Attorney General, Criminal Division, Department of Justice, and a letter in support of the legislation was sent by John C. Whitehead, Deputy Secretary of State.

THE PROPOSED LEGISLATION

TITLE I—RECIPROCAL INVESTIGATIVE ASSISTANCE

A. Authorization for SEC Investigative Assistance to Foreign Authorities

1. Overview of difficulties in international enforcement

Increasing internationalization of the capital markets has made more difficult the task of investigating alleged securities law violations.[1] In more and more cases, Commission investigators and litigators must obtain information from witnesses who reside in a foreign country and examine books, trading records and other evidence that is located abroad.[2]

The U.S. securities laws provide generally that the Commission's investigative subpoena power extends only to the production of documentary and testimonial evidence "from any place in the United States or any State." [3] If an individual or entity located in a foreign country refuses to cooperate voluntarily in the investigation, the Commission must seek the assistance of a foreign sovereign, or

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[1] See generally, Internationalization of the Securities Markets, Report of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce, dated July 27, 1987, Chapter VII.

[2] See, e.g., SEC v. *Certain Unknown Purchasers, et al.*, 81 Civ. 6553 (S.D.N.Y.) (WCC); *SEC* v. *Tome*, 833 F. 2d 1086 (2d Cir. 1987) *cert. denied* Nos. 87-1321, 87-1368 (May 16, 1988); *SEC* v. *Levine*, 86 Civ. 3726 (S.D.N.Y.) (RO). In each case, the defendants used bank accounts in countries with secrecy laws in an effort to conceal their identities and thereby shield their trading schemes from the Commission.

[3] Section 21(b) of the Exchange Act, 15 U.S.C. 78a(c). See, *CFTC* v. *Nahas*, 783 F.2d 487, 493 (D.C. Cir. 1984) (construing a provision in the Commodity Exchange Act which at the time was nearly identical to Section 21 (b) and (c) of the Exchange Act); *cf. SEC* v *A.H. Zanganeh*, 470 F. Supp. 1307 (D.D.C. 1978) (holding that the SEC could not subpoena the testimony of a foreign witness merely by serving the subpoena at the offices of a U.S. corporation organized to hold funds for his children).

wait until the individual enters the United States, to develop the necessary evidence. Even where the Commission effectively serves a subpoena in the United States to compel a person located here, or a subsidiary of a foreign corporation located here, to provide documents located abroad,[4] subpoena enforcement actions and contempt proceedings in such cases are expensive and protracted. In addition, particularly when secrecy laws are at issue,[5] court enforcement of a subpoena engenders the hostility of the foreign country, which views such a proceeding as an infringement of its sovereignty.

Once a lawsuit has commenced, the Commission has additional means of obtaining discovery. As to parties, a court may compel discovery, including testimony and the production of documents, pursuant to Federal Rules of Civil Procedure ("Fed. R. Civ. P.") 37. However, as with investigative subpoenas, the issuance of litigation subpoenas may create friction with foreign authorities. As to foreign nonparties, a court may issue letters rogatory to a foreign court pursuant to Fed. R. Civ. P. 28(b)(3). Where the country in which evidence is sought is a signatory to the Hague Evidence Convention,[6] the Commission may use letters of request, which are similar to letters rogatory.[7] Those procedures, however, can be extremely slow and expensive. In addition, restrictions on discovery techniques in certain countries—such as limitations on the right of counsel to directly examine witnesses—can render such procedures inadequate.[8]

2. Benefits of bilateral agreements

As a result of these difficulties, the Commission's enforcement efforts are greatly enhanced by bilateral agreements, or MOUs, between the Commission and foreign countries and securities authorities. Such agreements, which bring the Commission and its equivalent foreign regulator into a cooperative relationship, provide powerful means for international securities enforcement.[9]

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[4] See, e.g., *SEC* v. *Minas de Artemisia, S.A.*, 150 F.2d 215 (9th Cir. 1945); *see also, In re Marc Rich & Co.*, 707 F.2d 663 (2d Cir.), *cert. denied*, 463 U.S. 1215 (1983) (criminal tax investigation).

[5] Secrecy laws forbid the disclosure of business records or the identity of bank customers. The right to secrecy is held by the person whose secrecy is to be protected and can be waived solely by that person. See generally, Pitt, Hardison, and Shapiro, "Problems of Enforcement in the Multinational Securities Market," 9 U. Pa. J. of Int'l Bus. Law 385, 402–09 (1987).

[6] Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (the "Convention"), opened for signature March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444.

[7] See generally, E. Greene, A. Cohen, and L. Matlack, "Problems of Enforcement in the Multinational Securities Market," 9 U. Pa. J. of Int'l Bus. Law 325, 344–45 (1987).

[8] *See, Societe Nationale Industrielle Aerospatiale* v. *U.S. District Court for the Southern Dist. of Iowa*, 107 S.Ct. 2542 (1987) ("In many situations the Letters of Request procedure authorized by the Convention would be unduly time consuming and expensive as well as less certain to produce needed evidence than direct use of the Federal Rules").

[9] One commentary has described the benefits of MOUs as follows:

"The advantages of MOUs from the SEC's viewpoint are significant. First, a MOU can establish detailed procedures governing areas of concern. Second, a MOU can establish a timetable governing the handling of the SEC's request, and place reasonable limitations on customers' rights to appeal decisions to grant the SEC access. In addition, a MOU need not be formally ratified by the United States Senate and the corresponding body in the foreign jurisdiction, which permits the SEC to invoke the MOU's provisions at an earlier date. From the perspective of foreign jurisdiction, MOUs offer hope that the SEC will refrain from invoking the compulsory processes of the United States court which are viewed as a challenge to the sovereignty of the foreign jurisdiction." Pitt, Hardison and Shapiro, "Problems of Enforcement in the Multinational Securities Market," 9 U. Pa. J. Int'l Law 374, 435 (1987).

As described by Chairman Ruder in his testimony, the Commission entered into its first MOU in 1982 with Switzerland. Prior to that time, the Commission could utilize the 1977 Treaty on Mutual Assistance between the U.S. and Switzerland to obtain information.[10] As a condition of assistance, this treaty requires that the alleged acts violate the criminal laws of both the U.S. and Switzerland. However, until recently, insider trading was not a violation of Swiss law. To enable the Commission to obtain information in insider trading cases, the governments of the U.S. and Switzerland signed the MOU to establish "mutually acceptable means" for dealing with the problems of insider trading. The Swiss MOU provides a mechanism for Swiss banks under certain circumstances to disclose information to the Commission without violating the Swiss bank secrecy laws. The Commission has obtained important assistance and information pursuant to the Swiss MOU, and, in one case, successfully pursued a civil injunctive action based on assistance provided pursuant to the MOU.[11]

MOUs have also been signed with the United Kingdom, Japan, Canada, and Brazil. The Commission entered into the MOU with the Securities Bureau of the Japanese Ministry of Finance in 1986. It provides that each agency will facilitate the other's "respective requests for surveillance and investigatory information on a case-by-case basis." The Japanese MOU designates a specific contact person in each agency to enhance regular communication and processing of requests. Although the Japanese MOU is less specific than the Commission's other MOUs, it has succeeded in enabling the SEC to gather needed evidence.

Also in 1986, the SEC, the Commodity Futures Trading Commission, and the United Kingdom Department of Trade and Industry entered into an MOU which, on a reciprocal basis, provides assistance in obtaining records that are in the hands of the other agency or that can be obtained through the "best efforts" of the parties to the MOU. The U.K. MOU is viewed as an interim arrangement intended to be a first step in the parties' efforts to establish a comprehensive understanding to provide bilateral cooperation relating to securities regulation. The U.K. MOU makes assistance available in matters involving insider trading, market manipulation and misrepresentations relating to market transactions. It also provides for

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[10] The United States is a party to mutual assistance treaties with Switzerland (27 U.S.T. 2019), the Netherlands (T.I.A.S. 10734), Turkey (T.I.A.S. 9891) and Italy (Sen. Ex. 98-25, 98th Cong. 2d Sess.). The mutual assistance treaties between the U.S. and the Netherlands, Turkey and Italy can also be utilized by the Commission to obtain information and evidence in an investigation or during litigation. These treaties provide for the exchange of information in criminal matters and generally require that the violation under investigation constitute an offense under the laws of both the requesting and requested state.

Additionally, the Commission has utilized the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (the "Convention"), opened for signature March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444 to obtain evidence and testimony from the United Kindom, Guernsey, France and Italy. The Commission recently utilized the Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, open for signature, Nov. 15, 1965, 20 U.S.T. 361-373, T.I.A.S. No. 6638, 658 U.N.T.S., to serve judicial documents in the United Kingdom and Egypt.

[11] At the time the Swiss MOU was signed, it was agreed that once insider trading was made illegal in Switzerland, the MOU would cease operation. Insider trading legislation was recently enacted in Switzerland. The U.S. and Switzerland exchanged Diplomatic Notes in November 1987 to provide that, in insider trading cases, the 1977 Treaty on Mutual Assistance will now be used to provide assistance in Commission investigations relating to serious violations of U.S. securities laws.

exchange of information in matters relating to the oversight of the operational and financial qualifications of investment businesses and brokerage firms. Chairman Ruder testified that the SEC has on numerous occasions received and provided assistance and information pursuant to the United Kingdom MOU.

The Commission entered into an MOU on January 7, 1988, with the Ontario, Quebec and British Columbia securities commissions. The Canadian MOU exceeds the scope of assistance available under, and the subject matter covered by, the previous MOUs. It provides that the parties will provide each other with the fullest mutual assistance possible where information needed by one authority is in the territory of the other. The MOU provides that assistance will be available in the full range of cases investigated by the Commission. The Canadian MOU has already proven to be an effective means of obtaining and providing mutual assistance, and can be used as a basis for future agreements with other foreign regulatory authorities. It also provides that the parties will use their subpoena authority, where necessary, to obtain the information requested by another authority. The Quebec Securities Commission is the only signatory with such investigative authority at the present time.[12] The signatories to the MOU agreed to take "all reasonable steps" to obtain such stratutory authority to permit investigations of securities law violations at the request of a foreign authority.

On July 1, 1988, the SEC entered into an MOU with the Brazil Comissao de Valores Mobiliarios, the SEC's counterpart in Brazil. The Brazilian MOU is identical in every respect to the Canadian MOU except that it contains additional language making explicit the parties' intention to use the MOU mechanism to conduct compliance inspections of investment businesses, such as broker-dealers and investment companies, which engage in business in both jurisdictions.

The MOUs have provided an effective and efficient means of obtaining information and have enhanced the Commission's enforcement capabilities. Chairman Ruder informed the Committee that the Commission is negotiating MOUs with additional countries, and the Committee applauds those efforts.

The Commission's existing statutory authority, however, does not permit full cooperation between the Commission and foreign authorities in international investigations. The British MOU exemplifies the limitations. Under that agreement, each country undertakes to provide the other with "any information" that it has "in its hands" or that it can by "best efforts" obtain. In some cases, the Commission has important information in its hands. In other cases, where there is evidence of a possible violation of a law that has occurred in both this country and the foreign country, the Commission may investigate and then exchange information with the foreign country. But where there is no evidence of a possible violation of U.S. law, the Commission lacks authority to compel testimony or

[12] Securities Act, Qub. Rev. Stat. ch. V-1 (1977). Chairman Ruder testified that to his knowledge, the only other country with such authority is Switzerland, which provides such investigative assistance in cases where the offense under investigation would also violate Swiss criminal law and where reciprocal assistance is available from the requesting country.

production of documents on behalf of a foreign securities authority.[13] For example, if a U.S. bank holds documents evidencing the proceeds of a securities law violation which took place entirely abroad and which violated the laws of another country, and as to which the Commission therefore lacks jurisdiction, the Commission has no authority to compel production of the documents. The Commission's "best efforts," in other words, may in some cases be ineffective.

Foreign authorities confront many of the same obstacles to evidence gathering in this country that the Commission encounters in foreign countries. Absent assistance by the Commission or other government agencies, the only procedure now available to a foreign government seeking to investigate securities fraud in this country is letters rogatory under 28 U.S.C. 1782. That statute allows a federal district court, at the request of a "foreign or international tribunal," to issue letters rogatory to persons within its district to give testimony or produce evidence. The term "tribunal," however, has been interpreted as meaning a judicial or quasi-judicial body.[14] As a result, the letters rogatory procedure may not be available to foreign regulatory authorities in the investigative stage. In any event, the letters rogatory application must be reviewed by the U.S. court in an open proceeding. The public nature of the process and the frequent delays in U.S. courts make this procedure an impractical means for foreign authorities to investigate many securities law violations. In view of these limitations on evidence gathering in international securities fraud cases, the Committee believes that the SEC should have the authority to enter into cooperative investigative agreements with foreign authorities whereby authorities in one country can investigate a matter at the request of the authorities in the other country. S. 2544 would provide the SEC with such authority.

3. The proposed legislation

The legislation would amend Section 21(a) of the Exchange Act to provide:

> On request from a foreign securities authority, the Commission may, in its discretion, provide assistance in accordance with this paragraph if the requesting authority: (a) states that it is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that it administers or enforces; and (b) agrees to provide similar assistance to the Commission in securities matters. The Commission may conduct such investigation as it deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the

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[13] Under Section 21(a) of the Exchange Act, for example, the Commission's investigatory authority is generally limited to inquiries involving the laws it administers.

[14] See, e.g., *Fonseca* v. *Blumenthal*, 620 F.2d 322 (2d Cir. 1980). But see, Letter of Request from the Crown Prosecution Service of the United Kingdom, No. 88-0028 (D.D.C., March 21, 1988); In re Request for Assistance from Ministry of Legal Affairs of Trinidad and Tobago, 648 F. Supp. 464 (S.D. Fla. 1986).

> facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether compliance with the request would prejudice the public interest of the United States.

This legislation would expand the Commission's authority under Section 21 of the Exchange Act to allow a Commission investigation for the purpose of assisting a foreign authority to determine whether a violation of the laws it administers has occurred, is occurring, or is about to occur. The Commission's discretion to open the investigation to assist a foreign authority would be governed by the same standards as a domestic case. As a result, the proposal brings into play the full range of investigative procedures and remedies at the Commission's disposal, including the issuance and enforcement of subpoenas. By utilizing the investigative framework which already is in place, the proposal provides a vehicle with which the Commission and the legal community is familiar for assisting foreign authorities.

The legislation would give the Commission the discretion to issue a formal order of private investigation to assist in gathering information regarding alleged violations of foreign laws relating to securities matters. To protect against the possibility that the Commission might assist in an unfocused or unbound foreign "fishing expedition", it is contemplated that foreign authority seeking the Commission's assistance will submit a request stating the facts which constitute a potential violation of its laws.[15] The Committee anticipates that the Commission will carefully examine this request and make a determination whether to issue a formal order. If a formal order is issued, an investigation will be conducted in the U.S. by those persons appointed as officers of the Commission and the requested evidence will be fathered pursuant to normal procedures. Thus, commission control over the investigation and the application of the Commission's investigative procedure will apply to the investigation in the United States.

Because the proposed legislation relies upon established domestic procedures for investigations, it provides witnesses with all of the protection and remedies afforded to witnesses in Commission proceedings. Accordingly, witnesses could obtain access to a formal order identifying the basis and subject matter of an investigation. Further, they would be able to resist enforcement of an unlawful subpoena in the same manner as provided under existing law, see, e.g., *SEC* v. *Dresser Industries,* 628 F.2d 1368 (D.C. Cir. 1980).[16] The

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[15] For example, under the MOU with the U.K. Department of Trade and Industry, a request is required to clearly set forth: (a) the information requested; (b) the general purpose for which the information is sought, indicating in particular the legal rule or requirement pertaining to the matter which is the subject of the request; (c) the grounds on which breach of the legal rule or requirement is suspected or the reason the information is otherwise sought; (d) the identity of the person whose conduct causes concern.

[16] Although the Commission has statutory power to delegate authority to its staff to bring subpoena enforcement actions (see Section 4A of the Securities Exchange Act of 1934), the Committee understands that the Commission's current practice is that subpoena enforcement actions must be authorized by a vote of the Commission. The Committee further understands that the Commission intends to follow the same practice as to the enforcement of subpoenas issued pursuant to this legislation.

Committee believes, that by providing a witness with the same rights and protections provided to witnesses in commission investigations, the proposed legislation resolves any constitutional due process and Fouth Amendment concerns which could be raised.[17]

The legislation restricts assistance requests to "foreign securities authorities." That term is defined in the bill as "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters." This definition recognizes that countries have different approaches to securities law enforcement. In some countries—the United Kingdom, for example—jurisdiction over securities law enforcement has been assigned by statute to a government authority. In still other countries, a private agency is authorized to act as the primary administrator or enforcer for securities matters. The Committee intends that the definition of "foreign securities authority" encompass:

(a) foreign independent regulatory agencies similar to the Commission, such as the Commission des Operations de Bourse in France and the Canadian provincial securities commissions, as well as foreign Executive agencies, such as the British Secretary of State for the Department of Trade and Industry, which hold express statutory authority to enforce securities laws;

(b) general police entities, such as the Swiss Federal Department of Justice and Police, which enforce commercial, corporation and financial laws or other generalized fraud statutes; and

(c) self-regulatory organizations ("SROs"), such as the U.K. Securities and Investment Board (as of April 1988), to the extent the SRO is not merely a membership organization but also "administers" or "enforces" securities laws.[18]

The proposed amendment provides the Commission with discretion to grant or deny assistance. As a result, the Commission would not be required to provide assistance to an agency or regulatory organization of uncertain legal authority, or in response to an unreasonable or ill-founded request.

The legislation provides that the Commission may only grant assistance to a foreign authority that agrees to provide "similar assistance" to the Commission. The Committee believes that this requirement will provide a strong incentive for countries to agree to provide the SEC with assistance.

The legislation does not require that the matter under investigation would constitute a violation of U.S. law if it had occurred here.

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[17] Because testimony would be taken pursuant to existing investigative procedures, a witness would be entitled to assert all relevant rights and privileges of the United States. In addition, a witness would be entitled to assert privileges available in the country seeking the evidence even as to those matters which are not privileged under U.S. law. Issues of privilege would be preserved on the record of the investigative proceedings for later consideration by a court of the requesting authority. The committee anticipates that foreign countries providing reciprocal assistance to the Commission will follow a similar procedure.

[18] As discussed below, SROs which do not "enforce" or "administer" securities laws are included under this legislation in the broader definition of "foreign financial regulatory authority." By requiring that the "foreign securities authority" be the originator of requests, the Commission anticipates that it will receive requests for assistance from a single authority or only a few authorities in one country instead of from a wide range of SROs with varying responsibilities. This approach will enable the Commission to develop a working relationship with the authorities who have the broadest legal mandate to oversee securities matters in their country.

Such a dual criminality requirement would inhibit the Commission's ability to be responsive to foreign requests. Moreover, because U.S securities laws are broader than those in most other countries, the imposition of a dual criminality requirement by other countries could seriously restrict the Commission's ability to obtain assistance by limiting the applicability of bilateral agreements to a narrow range of cases.

B. Exemption From the Freedom of Information Act for Confidential Foreign-Obtained Documents

1. The need for legislation

In entering into MOUs with the SEC, authorities in foreign countries have committed themselves to obtaining and providing the Commission with documents, some of which otherwise would be kept confidential under the foreign country's laws. While these authorities have determined that it is appropriate to permit public use of these documents, which otherwise must be kept confidential, when the Commission prosecutes securities law violators, they have expressed concern about the disclosure of such documents when the SEC decides not to prosecute a particular matter.

Under the Freedom of Information Act, 5 U.S.C. 552, the SEC cannot assure foreign authorities that the confidentiality of any documents furnished to the Commission will be maintained. The Commission's disclosure obligations under the FOIA are the same for records obtained from foreign securities authorities as they are for records obtained from other sources, i.e., the documents must be disclosed under the FOIA unless they fall within a specified FOIA exemption. Because of these FOIA obligations, the SEC has informed the Committee that foreign securities authorities have expressed concerns about providing the Commission with information relevant to ongoing investigations. They have also stated that their own domestic laws preclude them from entering into agreements with the Commission unless the Commission is able to fulfill the confidentiality requirements of the foreign country's laws.

S. 2544 would create a narrow exemption from the FOIA for foreign-obtained documents that, under the applicable foreign law, are required to be kept confidential. The Committee believes that principles of comity make it appropriate to exempt from disclosure confidential documents obtained from a foreign government if those documents could not be disclosed under the laws of that foreign government. Moreover, adoption of such an amendment will almost certainly allow the SEC to obtain otherwise unobtainable confidential documents from foreign countries for law enforcement purposes. These considerations warrant enactment of the FOIA exemption.[19]

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[19] The Committee intends that this provision would also exempt from disclosure a foreign securities authority's request for investigative assistance, made pursuant to Section 21(a) as amended by this legislation, when that authority represents that public disclsuure of that request would be contrary to the laws of the requesting country. As a result, the foreign securities authority's investigative assistance request would be placed on an equal footing with the SEC's Formal Orders of Investigation, which initiate a formal SEC investigation in which compulsory process is authorized, see, e.g., Section 21(a) of the Securities Exchange Act. Formal Orders are exempt from disclosure under FOIA Exemption 7(A), which applies to "records or information compiled for law enforcement purposes" where disclosure "could reasonably be expected to interfere with enforcement procedings * * *."

2. The proposed legislation

The legislative proposal would amend Section 24 of the Exchange Act by adding the following new provisions:

> (d) Notwithstanding the provisions of the Freedom of Information Act, 5 U.S.C. 552 or of any other law, the Commission shall not be compelled to disclose records obtained from a foreign securities authority if the foreign securities authority has in good faith represented to the Commission that public disclosure of such records by such authority would be contrary to the laws of the foreign country from which they were obtained.
>
> (e) Nothing in this Section shall prevent the Commission from complying with a request for information from the Congress or from complying with an order of a court of the United States in an action commenced by the United States or the Commission.

The proposed Section 24(d) would supersede the FOIA by authorizing the Commission to withhold from disclosure documents obtained from a foreign securities authority if the foreign authority has in "good faith" represented to the Commission that public disclosure of such records would be contrary to the laws of the foreign country. The term "foreign securities authority" would include, as discussed above, government agencies and self-regulatory organizations which "administer" or "enforce" the securities laws. The bill would not restrict the Commission's use of the information and documents obtained from a foreign authority. Nor would it limit the ability of the Congress to obtain information in the Commission's possession or preclude defendants in actions commenced by the United States or the Commission from seeking, through discovery or otherwise, such documents as appropriate.[20] The legislation would add a new Section 24(e) to make clear that the amendment would not prevent the Commission from complying with a request for information from the Congress or from complying with an order of a court of the United States in an action commenced by the United States or the Commission. The Commission shall have an affirmative obligation to compil with any request for information from the Congress. This amendment would render unnecessary the existing last sentence of Section 24(b) of the Exchange Act, which provides that "nothing in this subsection shall authorize the Commission to withhold information from the Congress." That sentence, therefore, would be deleted.

By providing authority for the Commission to withhold from disclosure certain records obtained from foreign securities authorities "in response to a request pursuant to the Freedom of Information Act," the amendment would supersede the disclosure obligations imposed by the FOIA, and hence would not require that the Commission rely solely on an existing FOIA exemption in order to withhold confidential documents from disclosure.[21] In addition, the de-

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[20] The amendment, by providing "notwithstanding the provision of * * * any other law," also authorizes the Commission to withhold documents subject to a third-party subpoena.

[21] Certain statutes have been found to preempt or supersede FOIA. See, e.g., Ricchio v. *Kline*, 773 F.2d 1389, 1392 (D.C. Cir. 1985) (holding that FOIA was preempted by the Presidential Re-

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termination whether foreign law prohibits the disclosure would be made by the foreign authorities, not by the Commission. That decision must, however, be made in good faith.[22]

C. Authorization for Commission Rulemaking Authority to Permit Access to Its Files by Persons, Both Domestic and Foreign, Engaged in Securities Law Enforcement and Oversight

1. The need for legislation

The SEC has adopted rules [23] which permit access to non-public materials in the Commission's investigative files to domestic and foreign governmental authorities, self-regulatory organizations, and other specified persons. These rules have frequently provided the essential basis for prosecutions of securities law violations by other enforcement agencies and SROs.

The Committee applauds the SEC's cooperative enforcement efforts with other enforcement officials, both foreign and domestic. However, Congress may have, without intending to do so, erected statutory barriers to the sharing of certain documents in certain cases. In particular, Section 24(b) of the Exchange Act, 15 U.S.C. 78x(b), enacted in 1975, makes it unlawful "for any member, officer, or employee of the Commission to disclose to any person other than a member, officer or employee of the Commission, or to use for personal benefit, any information contained in any application, statement, report, contract, correspondence, notice or other document filed with or otherwise obtained by the Commission (1) in contravention of the rules and regulations of the Commission under [the FOIA], or (2) in circumstances where the Commission has determined pursuant to such rules to accord confidential treatment of information." Section 24(b) was intended to make all requests for confidential treatment of information subject to the FOIA rules.[24] There is nothing in the legislative history suggesting that Congress intended to restrict the Commission's authority to provide information and records to other authorities. Nevertheless, the literal language of Section 24(b) can pose an obstacle to compliance with an access request. In addition, Section 210(b) of the Investment Advisors Act bars the staff from making public information relating to a Commission investigation if it was obtained pursuant to that Act, unless the Commission expressly authorizes such disclosure (with an exception for public hearings and disclosure to Congress). Section 45(a) of the Investment Company Act imposes a bar on the disclosure of non-public documents obtained by the Commission pursuant to that Act, except insofar as disclosure is made to federal or state government officials.

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cordings and Materials Preservation Act, the sole purpose of which is "to preserve" and "to provide access to" a certain specific body of records).

[22] The "good faith" requirement is intended to permit the Commission to inquire into the legitimacy of the foreign government's non-disclosure request.

[23] See, e.g., Rule 30-4(a)(7), 17 C.F.R. 200.30-4(a)(7).

[24] Prior to the 1975 Amendment, the Commission provided confidential treatment under both the FOIA rules and under Section 24(a), which at that time prescribed standards for granting confidential treatment to information filed with the Commission. The Amendments were intended to end the latter procedure. *See* S. Rep. No. 94-75, 94th Cong., 1st Sess. 137, reprinted in 1974 U.S. Cong. & Admin. News 179, 314.

Congress did not intend to restrict the SEC's authority to share information and documents with other regulators and enforcement officials. In order to remove any statutory obstacles to the Commission's authority to grant access to its files to domestic and foreign authorities, the legislation would provide the Commission with explicit authority in this area.

2. The proposed legislation

The proposed legislation would amend Section 24 of the Exchange Act by adding subsection (c) as follows:

> (c) Notwithstanding any other provision of law, the Commission may in its discretion and upon a showing that such information is needed, provide all "records" (as defined in subsection (a) above) and other information in its possession to such persons, both domestic and foreign, as the Commission by rule deems appropriate;
>
> *Provided,* That the person receiving such records or information provides such assurances of confidentiality as the Commission deems appropriate; and
>
> *Provided further,* That nothing in this section shall alter the Commission's responsibilities under the Right to Financial Privacy Act, 12 U.S.C. 3401 et seq., as limited by Section 21(h) of the Securities Exchange Act, 15 U.S.C. 78u(h), with respect to transfers of records covered by such statutes.

The legislation would grant the Commission rulemaking authority so as to provide the SEC with the flexibility to adjust its regulations governing access requests in the future. The provision as to confidentiality of records is intended to ensure that the Commission will not provide records to persons who will make the records public for purposes other than those stated in an access request.[25]

The legislation would make clear that the Commission may provide access to foreign, as well as domestic, persons. The Committee anticipates that the Commission will adopt rules permitting access to the authorities included in the definition of "foreign securities authority", i.e., "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters." As discussed above (supra, pages 11–12), the Committee intends that this definition encompass foreign independent regulatory agencies, foreign executive agencies, general police authorities, and foreign self-regulatory agencies.

The legislation would not alter the certification and notice requirements imposed by the Right to Financial Privacy Act ("RFPA"), 12 U.S.C. 3401 et seq. Under Section 1112(a) of the RFPA, the Commission may not transfer to other federal agencies financial records that were obtained by the Commission subject to

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[25] SEC policy now requires that the person making the access request state the purposes for which the requested information will be used and certify that no public use will be made of the information except for the purposes specified. It is expected that these or similar procedures would continue to be used after the legislation is enacted. In addition, in the international context, MOUs delineate the public uses that can be made of information which the SEC provides pursuant to the access program.

the RFPA Procedures unless it certifies in writing that there is reason to believe that the records are relevant to a legitimate law enforcement inquiry within the jurisdiction of the receiving agency or department. In addition, the Commission must send the customer a copy of such certification and a notice which both describes the nature of the law enforcement inquiry and informs the customer of potential legal rights under relevant privacy statutes. These requirements do not apply to transfers of information to non-federal agencies, foreign authorities, or self-regulatory organizations.[26]

TITLE II—IMPOSITION OF SANCTIONS ON SECURITIES PROFESSIONALS FOR MISCONDUCT ABROAD

A. The Need for Legislation

1. Overview

One likely result of efforts by foreign securities authorities to strengthen their securities law enforcement will be an increase in the number of enforcement or disciplinary proceedings brought against securities professionals, such as brokers, dealers, and investment advisers. Indeed, if this legislation is enacted, such action may result at least in part from the assistance provided to foreign authorities by the Commission pursuant to this legislation. The SEC, however, currently does not have explicit authority to impose administrative sanctions against such professionals based upon foreign findings of their illegal or improper foreign activities (although, as discussed below, the Commission has some authority in this area).

The Committee believes that, as the securities markets become increasingly internationalized, the SEC should have such authority. Title II of S. 2544 therefore provides that the Commission may impose sanctions on securities professionals who have been found to have engaged in misconduct abroad when, had the same misconduct taken place in the United States, the professional would have been subject to a Commission disciplinary proceeding. It is important to note that the Commission would have discretion to bring an administrative proceeding based on foreign misconduct, just as it has discretion to bring such actions based on domestic misconduct. Title II would amend Sections 15(b)(4) and 3(a)(39) of the Exchange Act; Section 9(b) of the Investment Company Act; and Section 203(e) of the Investment Advisers Act to provide the Commission with this express authority and to add to the Commission's existing authority.

2. Specific concerns

U.S. broker-dealers, investment advisers, and investment companies have increased significantly their activities in foreign markets.[27] The activities of foreign professionals in the U.S. markets

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[26] See H.R. Rep. No. 95–1383, 95th Cong., 2d. Sess., (1978) at 247.

[27] See Report, supra note 1, at Chapter II. As to investment companies, the report states that there has been a dramatic increase in the number of U.S. investment companies that emphasize foreign securities in their portfolios and that it has become more common for investment companies registered in the U.S. to issue their securities in foreign markets.

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also are likely to increase.[28] As a result, the SEC is likely to confront a growing number of securities professionals, who have been disciplined abroad for illegal or improper activities, working or seeking to work in this country.

The Commission currently has substantial authority to curtail the securities activities of certain convicted criminals and other wrongdoers who engaged in illegal or improper conduct in this country. Under Section 15(b)(4) and (b)(6) of the Exchange Act, the Commission may censure, limit the activities, functions, or operations of, suspend for up to twelve months, or revoke the registration of any broker or dealer, or bar from association with any broker or dealer, any person: found to have violated the federal securities laws, rules, or regulations thereunder; convicted of a "felony or misdemeanor" within the preceding ten years involving specified crimes; who willfully has filed a false or misleading statement in any registration statement or report filed with the Commission; or who has willfully aided and abetted a violation of any portion of the federal securities or commodities laws. Such a person also is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act.[29] Section 203(e) and (f) of the Investment Advisers Act provides the Commission with disciplinary authority as to investment advisers and persons associated with registered investment advisers, similar to that in Section 15(b)(4) and (6) of the Exchange Act.[30]

In addition, Section 9(a) of the Investment Company Act generally prohibits a person convicted of a securities-related crime or subject to a securities-related injunction from serving as an employee, officer, director, member of an advisory board, investment adviser, or depositor of a registered investment company, or principal underwriter for any registered open-end company, unit investment trust, or face-amount certificate company. The automatic statutory

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As of January 1988, there were 154 registered investment companies of all types that concentrate their portfolio securities in foreign securities. These funds, which are widely held by U.S. investors, use foreign broker-dealers to execute portfolio transactions, foreign custodians to hold portfolio securities and foreign advisers to help manage their portfolios. As to broker-dealers, major foreign markets usually facilitate entry by granting national treatment to U.S. securities firms. France has substantially increased access to its markets by foreign firms, id. at V-3, and the Tokyo Stock Exchange recently increased the number of seats allocated to foreign firms. Affiliates of U.S. broker-dealers now engage in significant market-making activities in London. Id. at V-21.

[28] See id. at I-14-16; II-78-90. The report indicates that over 120 investment advisers from 20 countries have registered with the Commission. The SEC has informed the Committee that it is considering the possibility of reciprocal arrangements between the U.S. and foreign nations with respect to multinational offerings of mutual fund securities. In addition, recently adopted Rule 6c-9 will facilitate the offering of foreign bank securities in the U.S. Investment Company Act Rel. No. 16093 (Oct. 29, 1987).

As to broker-dealers, about 150 foreign firms had established branches in the United States as of 1987; for their part, U.S. firms had over 250 branches in foreign countries, excluding Canada and Mexico. Id. at Chapter V, Appendix B-66 (remarks of James M. Davin, Vice-Chairman, NASD).

[29] As a result, when such a person seeks to become associated with a member of an SRO, that SRO and the Commission have the opportunity to give special review to the person's employment application or to restrict or prevent reentry into the business where appropriate for the protection of investors. See Section 15A(g)(2) of the Exchange Act and Rule 19h-1 thereunder.

[30] Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit the activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). As a result, any addition to the Commission's authority under Section 15(b)(4) and Section 203(e) will, by implication, expand the Commission's authority under Section 15(b)(6) and Section 203(f).

disqualification in Section 9(a) is supplemented by the Commission's authority under Section 9(b). Under Section 9(b), the Commission may prohibit a person from serving in any of the capacities cited in Section 9(a) or as an affiliated person of a registered investment company's investment adviser, depositor, or principal underwriter if the person willfully has caused a false or misleading statement to be made in any registration statement or report filed with the Commission or if the person has willfully violated or aided and abetted a violation of any provision of the federal securities or commodities laws.

Although the foregoing provisions do not mention the Commission's authority to impose sanctions based on foreign misconduct, certain of the provisions can be so applied. In particular, Sections 15(b)(4)(B) of the Exchange Act, 203(e)(2) of the Investment Advisers Act, and 9(a)(1) of the Investment Company Act refer to a "felony or misdemeanor" conviction for specified crimes; neither the statutes nor their legislative histories specify that the crime or conviction must take place in the United States.[31] Thus, pursuant to Section 15(b)(4)(B), the Commission revoked the U.S. registration of a Canadian broker-dealer who was convicted of crimes in Canada involving the purchase or sale of securities.[32] Likewise, under Sections 15(b)(4)(C) of the Exchange Act and 203(e)(3) of the Investment Advisers Act, the Commission may impose sanctions based upon a securities-related injunction entered by a "court of competent jurisdiction," and under Section 9(a)(2) of the Investment Company Act, such an enjoined person's association with a registered investment company is limited. These statutes are not explicitly limited to injunctions entered by U.S. courts.[33]

As to other provisions, however, such authority is lacking. First, the Commission's authority to impose sanctions on a professional[34] and to restrict association with a registered investment company[35] for a misstatement in an application for registration or report filed with the Commission does not extend to misstatements made to foreign regulatory authorities. Second, the Commission's authority to impose sanctions on the professional [36] or to restrict association with a registered investment company [37] for willful violation of the U.S. securities and commodities laws does not extend to violations of foreign securities laws. Finally, the Commission's authority to impose sanctions on professionals for aiding and abetting a viola-

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[31] See Investment Trusts and Investment Companies: Hearings Before a Subcommittee of the Senate Committee on Banking and Currency, 76th Cong. 3d Sess. 7, 31, 559 (Statement of Honorable Charles F. Adams) (1940); Investment Trusts and Investment Companies: Hearings Before a Subcommittee on the House of Representatives Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 13, 46, 97 (1940). As to Section 15(b)(4)(B) of the Exchange Act (originally Section 15(b)(5)(B), see Report to accompany H.R. 6793, H. Rep. No. 1418, 88th Cong., 2d Sess. 21 (1964).

[32] In the Matter of R.P. Clarke & Co., 10 S.E.C. 1072 (1942). See also L. Loss, Securities Regulation 1303, n.51 (2d ed. 1961) (citing R.P. Clarke decision and stating that the Commission may impose sanctions under Section 15(b)(4)(B) based upon a conviction in a foreign court).

[33] See L. Loss, supra at 1305 (stating that a "court of competent jurisdiction" as set forth in Section 15(b)(4)(C) may include a foreign court).

[34] See Section 15(b)(4)(A) of the Exchange Act and Section 203(e)(1) of the Investment Advisers Act.

[35] See Section 9(b)(1) of the Exchange Company Act.

[36] See Section 15(b)(4)(D) of the Exchange Act and Section 203(e)(1) of the Investment Advisers Act.

[37] See Section 9(b)(2) of the Exchange Company Act.

tion or failing reasonably to supervise a person subject to the professional's control in violation of the U.S. securities laws[38] and to restrict association with a registered investment company of personnel who are found to have aided and abetted such violations[39] does not extend to activities that violate foreign securities and commodities laws. The legislation would provide the Commission with authority to act in each of these circumstances.

In addition, as to the provisions under which, as discussed above, the Commission has authority to impose sanctions, the legislation would make such authority explicit and would preclude certain challenges which might be possible under the existing statutes. In particular, Section 15(b)(4)(B) of the Exchange Act, Section 203(e)(2) of the Investment Advisers Act, and Section 9(a)(1) of the Investment Company Act refer to convictions for a "felony or misdemeanor" as the basis for a Commission sanction. A securities professional who was convicted in a country that does not define crimes as "felonies" or "misdemeanors" might challenge the Commission's authority under these sections. A Commission administrative sanction also could be challenged when the foreign offense for which the securities professional was convicted is not one of the exact offenses specifically covered by the statutory provisions. As discussed below, the proposed legislation would undercut such defenses by providing for Commission sanctions based upon foreign convictions for crimes "substantially equivalent" to those listed in the statute. The legislation also would foreclose the potential argument that the statutory provisions [40] that allow the Commission to impose sanctions on professionals who have been enjoined from acting in specific capacities, such as underwriters or investment advisers, do not apply to persons whose profession is not so defined in a foreign country. The proposed amendments would resolve the potential difficulties posed by differences in employment terms by permitting sanctions based upon an injunction entered against a professional who performs a "substantially equivalent" function to the activities currently listed in the statute.

The proposed legislation would also create a "statutory disqualification," as defined in Section 3(a)(39) of the Exchange Act, when a foreign securities authority or foreign court makes findings of illegal or improper conduct.

The Commission's action against a securities professional would not be automatic. The statutory procedure for imposing sanctions for foreign misconduct would be the same as that currently in place for imposing sanctions for domestic misconduct. The Commission would provide the securities professional with notice and an opportunity for a hearing prior to taking such action. The securities professional thus would have an opportunity to present evidence on his own behalf, in order to demonstrate that the imposition of sanctions would not be in the public interest. In addition, if the professional makes a persuasive due process or jurisdictional attack on the foreign adjudicative proceedings, the Commission

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[38] See Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(1) of the Investment Advisers Act.

[39] See Section 9(b)(3) of the Exchange Company Act.

[40] Section 15(b)(4)(C) of the Exchange Act; Section 203(e)(3) of the Invetment Advisers Act; and Section 9(a)(2) of the Investment Company Act.

may be required to permit relitigation of the underlying offense. In such a case, the foreign finding of misconduct would provide the basis for a Commission administrative proceeding even though principles of collateral estoppel might not be available to the Commission.[41]

3. The proposed legislation

Title II of the proposed legislation would add new subsections 15(b)(4)(G) to the Exchange Act, 203(e)(7) to the Investment Advisers Act, and 9(b)(4) to the Investment Company Act. These provisions would apply the proscriptions of Section 15(b)(4)(A), (D), and (E) of the Exchange Act, Section 203(e)(1), (4), and (5) of the Investment Advisers Act, and Section 9(b)(1)–(3) of the Investment Company Act to an international context. Thus, the Commission would be able to impose sanctions on the professional if he has been found by a "foreign financial regulatory authority"—a defined term in the Acts—to have made false or misleading statements in registration statements or reports filed with a foreign securities authority; violated foreign statutory or regulatory provisions regarding securities or commodities transactions; or aided, abetted, or otherwise caused another person's violation of such foreign securities or commodities provisions or failed to supervise a person who has committed a violation of such provisions. The term "foreign financial regulatory authority" would be defined in new Sections 3(a)(51) of the Exchange Act, 202(a)(24) of the Investment Advisers Act, and 2(a)(50) of the Investment Company Act to include a "foreign securities authority" or organization that is essentially equivalent to a self-regulatory organization. The term "foreign securities authority," in turn, is defined in new Sections 3(a)(50) of the Exchange Act, 202(a)(23) of the Investment Advisers Act, and 2(a)(49) of the Investment Company Act as "any foreign government or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws relating to securities." [42]

Subsections 15(b)(4)(G), 203(e)(7), and 9(b)(4) are substantially similar to the aforementioned subsections of 15(b)(4), 203(e), and 9(b). The most significant difference between the existing and the new provisions is that the legislation would not require that the foreign authorities find "willful" misconduct, *i.e.*, a "willful" false filing, a "willful" statutory violation, or "willful" secondary liability. The Committee believes that this change is appropriate because of a potential disparity of willfulness in different countries and because some countries may not require a "willful" violation.

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[41] Similarly, in a Commission review, pursuant to exchange Act Section 19(d)–(f), of an SRO disciplinary or membership proceeding against a person subject to a statutory disqualification, the Commission might find it necessary to remand the proceeding to the SRO for relitigation of the underlying offense in cases where persuasive due process or jurisdictional challenges to the foreign proceeding are made.

[42] As noted (supra note 28), Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). Because Title II requires the addition of new paragraphs in Section 15(b)(4) and Section 203(e), the legislation will provide for conforming amendments to Section 15(b)(6) and Section 203(f). Title II would also make conforming amendments to Sections 15B(c), 15C(c), 15C(f) and 17A(c) of the Exchange Act.

The proposed language would provide the Commission with flexibility in deciding whether the facts of a particular case warrant imposition of sanctions.

In addition, Section 15(b)(4)(B) of the Exchange Act and Section 203(e)(2) of the Investment Advisers Act would be amended to grant the Commission explicit authority to consider convictions by a foreign court of competent jurisdiction of any crime enumerated in current Section 15(b)(4)(B) and Section 203(e)(2) or a "substantially equivalent" foreign crime; Section 15(b)(4)(C) of the Exchange Act and Section 203(e) (3) of the Investment Advisers Act would be amended to state explicitly that the Commission may consider injunctions imposed by a foreign court of competent jurisdiction in connection with any of the activities designated in the statute, or a "substantially equivalent" foreign activity. The Commission would have authority to restrict association with a registered investment company based on the same factors in new subsections 9(b)(5) and (6).

It should be noted that the Committee, consistent with the SEC's position, determined not to amend Section 9(a) of the Investment Company Act, which prohibits association in certain capacities with a registered investment company by persons who have been convicted of certain offenses or who have been subject to specified injunctions. Section 9(a) is a self-policing mechanism, the purpose of which "is to prevent persons with unsavory records from occupying these positions where they have so much power and where faithfulness to the fiduciary obligations is so important."[43] The automatic disqualification provisions of Section 9(a), coupled with the Commission's exemptive authority under Section 9(c) to avoid any inequitable results, are indispensable means of safeguarding the integrity of registered investment companies. However, due process concerns may be presented by legislation that would automatically bar a person solely on the bais of a foreign finding of a violation of foreign law, without any prior notice or opportunity for hearing by a U.S. court or administrative agency. These concerns are avoided if the Commission determines, on a case-by-case basis, whether the foreign finding justifies a bar, rather than relying exclusively on a foreign finding of a violation of foreign law. The amendment would not create any competitive disparities because, just as Section 9(a) applies equally to U.S. and foreign persons that have been convicted or enjoined in a manner specified in the statute, amended Section 9(b) would grant the Commission authority to institute an administrative proceeding against either a U.S. or foreign person that has committed an equivalent foreign violation and has been sanctioned by a foreign authority.

Finally, the legislation would amend Section 3(a)(39). That section establishes the bases for imposing a "statutory disqualification" on a broker or dealer, thereby subjecting it to the possibility of disciplinary sanctions by the Commission or a self-regulatory organization as set forth in Section 15A(g)(2) of the Exchange Act and Rule 19h-1 thereunder. The legislation would amend Section

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[43] Hearings on S. 3580 Before a Subcomm. of the Sen. Comm. on Banking and Currency, 76th Cong., 3d Sess. 46 (1940).

3(a)(39) by creating a statutory disqualification for misconduct in foreign countries.

CONCLUSION

S. 2544 would promote the negotiation of mutual assistance agreements which enhance the Commission's ability to obtain evidence for the investigation and prosecution of securities law violators operating in or through foreign countries. In addition, the legislation would clarify the statutory authority for the Commission's access rules. Finally, the legislation would provide the Commission with expanded authority to bring administrative proceedings against securities professionals based upon their illegal or improper activities in foreign countries. In view of the rapid internationalization of the securities markets, this is important and needed legislation.

SECTION-BY-SECTION ANALYSIS OF THE PROPOSED LEGISLATION

Section 101.—Section 101 of the Act amends the Securities Exchange Act of 1934 ("Exchange Act") to authorize the Commission to conduct investigations on behalf of foreign securities authorities. Thus, this Section expands the Commission's investigative powers so that it may investigate certain matters in the United States related to foreign securities law violations as to which the Commission lacks jurisdiction. Such authority will enhance international cooperation in enforcement of securities laws.

Section 101(a).—Subsection 101(a) amends Section 3(a) of the Exchange Act by adding new Subsection 3(a)(50) defining "foreign securities authority." Such an authority is defined as any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters. It is intended that this definition will encompass: (a) foreign independent regulatory agencies similar to the Commission, such as the Commission des Operations de Bourse in France, as well as foreign Executive agencies, such as the British Secretary of State for the Department of Trade and Industry, which hold express statutory authority to enforce securities laws; (b) general policing entities, such as the Swiss Federal Department of Justice and Policy, which enforce commerical, corporation and financial laws or other generalized fraud statutes; and (c) self-regulatory organizations ("SRO's"), such as the U.K. Securities and Investment Board (as of April 1988), to the extent the SRO is not merely a membership organization but also "administers" or "enforces" securities laws.

Section 101(b).—Subsection 101(b) is a technical amendment that redesignates Subsection 21(a) of the Exchange Act as Subsection 21(a)(1). This change is necessitated by the addition of Subsection 21(a)(2) to the Exchange Act, made by Subsection 101(c).

Section 101(c).—Subsection 101(c) adds new Subsection 21(a)(2) to the Exchange Act, authorizing the Commission to provide assistance to foreign securities authorities upon the foreign authority's request. The requesting authority must state that it is conducting an investigation which it deems necessary to determine whether any persons has violated, is violating, or is about to violate any

laws or rules relating to securities matters that it administers or enforces. The requesting authority must also agree that it will provide similar investigative assistance to the Commission. The Commission has discretion in deciding whether to conduct an investigation on behalf of the foreign securities authority. In deciding whether to grant assistance, the Commission is required to consider whether compliance with the request would prejudice to public interest of the United States. This subsection will provide the basis for achieving agreements with foreign securities authorities in which they agree to provide assistance to the Commission by conducting investigations at the request of the Commission.

Section 102.—Section 102 of the Act amends Section 24 of the Exchange Act by adding new subsections authorizing the Commission to withhold from disclosure documents furnished to the Commission by foreign securities officials upon certain conditions.

Section 102(a).—Subsection 102(a) is an amendment necessitated by the scheme of amended Section 24 of the Exchange Act, to which the Act adds several subsections. It strikes from Subsection 24(b) the sentence, "Nothing in this subsection shall authorize the Commission to withhold information from the Congress." That sentence becomes part of new Subsection 24(e) of the Exchange Act under Subsection 102(b) of the Act.

Section 102(b).—Subsection 102(b) adds new Subsection 24(c) to the Exchange Act. This subsection clarifies the Commission's authority to provide records, as defined in Exchange Act Subsection 24(a), in its discretion and upon a showing that the information is needed, to any persons deemed appropriate by the Commission by rule. The Subsection conditions this discretionary authority on the person receiving the information assuring its confidentiality as the Commission deems appropriate. It further clarifies that this section does not alter the Commission's responsibilities under the Right to Financial Privacy Act, 12 U.S.C. 3401 et seq., as limited by Section 21(h) of the Exchange Act, with respect to transfers of records covered by these statutes. Subsection 102(b) of the Act also adds new Subsection 24(d) to the Exchange Act. Subsection 24(d) states that notwithstanding the provisions of the Freedom of Information Act or of any other law, the Commission shall not be compelled to disclose records obtained from a foreign securities authority, if the foreign authority has in good faith represented to the Commission that public disclosure of such records would be contrary to the laws of the foreign country from which they were obtained. This amendment will allow the Commission to obtain otherwise unobtainable confidential documents from foreign countries for law enforcement purposes. As mentioned above, Subsection 102(b) of the Act also adds new Subsection 24(e). This subsection clarifies that nothing in Section 24 authorizes the Commission to withhold information from Congress or not to comply with an order of a United States court in an action initiated by the United States or the Commission. The Commission shall have an affirmative obligation to comply with any request for information from the Congress.

Section 201.—Section 201 of the Act amends the Exchange Act to authorize the Commission to impose sanctions on brokers or dealers, their associated persons, and individuals seeking to become as-

sociated persons of brokers or dealers on the basis of misconduct in a foreign country.

Section 201(a).—Subsection 201(a) of the Act amends Exchange Act Section 15(b), the Exchange Act's registration provision. Subsection (a)(1) provides for Commission censure of, limitations on the activities of or revocation or suspension of the registration of brokers or dealers, based upon a conviction within ten years rendered by a foreign court of competent jurisdiction of a crime which is substantially equivalent to a felony or misdemeanor as provided by Subparagraph 15(b)(4)(B). The Act thus clarifies the Commission's authority to consider offenses from foreign jurisdiction that might not classify crimes formally as felonies or misdemeanors, e.g., non-common law jurisdictions.

Subparagraph 15(b)(4)(B)(i) lists offenses involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense as within the class of felonies and misdemeanors that permit the Commission to sanction brokers or dealers. Subsection (a)(2) of the Act amends Subparagraph 15(b)(4)(B)(i) by including within this list any substantially equivalent activity, however, denominated by the laws of a foreign government. The Act therefore clarifies the Commission's authority to consider such activities even if the foreign government does not denominate them as precisely the same offenses that they constitute within the United States.

Subparagraph 15(b)(4)(B)(ii) also allows the Commission to consider offenses arising out of the conduct of various securities-related businesses, including the business of a broker, dealer, municipal securities dealer, government securities broker, government securities dealer, investment adviser, bank, insurance company, fiduciary, or transfer agent. Subsection (a)(3)(A) amends Subparagraph 15(b)(4)(B)(ii) by including any substantially equivalent activity, however, denominated by the laws of a foreign government. The Act accordingly clarifies the Commission's authority to consider such offenses regardless of the employment terms involved, which may differ in foreign countries. Subparagraph 15(b)(4)(B)(ii) also permits the Commission to consider offenses arising out of the conduct of the business of an entity or person required to be registered under the Commodity Exchange Act (7 U.S.C. 1 et seq.). Subparagraph (a)(3)(B), therefore, also amends Subparagraph 15(b)(4)(B)(ii) by including any equivalent foreign statute or regulation. The Act thus clarifies the Commission's authority to consider foreign offenses arising out of the commodities trading business.

Subparagraph 15(b)(4)(B)(iii) includes larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, and misappropriation of funds or securities within the list of offenses that trigger Commission sanctions. Subsection (a)(4) of the Act adds any substantially equivalent activity, however denominated by the laws of a foreign government. Subsection (a)(4) of the Act clarifies Commission authority on this point in the same way and for the same reasons as Subsection (a)(2).

Subparagraph 15(b)(4)(B)(iv) includes violations of sections 152, 1341, 1342, or 1343 or chapter 25 or 47 of title 18 of the U.S. Code

within the list of offenses that the Commission may consider. These provisions concern concealment of assets, false oaths and claims, and bribery in connection with bankruptcy; mail fraud; wire fraud; counterfeiting and forgery; and fraud and false statements, respectively. Subsection (a)(5) amends Subparagraph 15(b)(4)(B)(iv) by including a violation of a substantially equivalent foreign statute. Subsection (a)(5) of the Act clarifies Commission authority on this point in the same way and for the same reasons as Subsection (a)(2).

Subparagraph 15(b)(4)(C) also empowers the Commission to impose sanctions on the basis of permanent or temporary injunctions against acting in the securities-related or commodities-related capacities enumerated in Subparagraph 15(b)(4)(B)(ii) and against engaging in or continuing any conduct or practice in connection with such activity or in connection with the purchase or sale of any security. Subparagraph (a)(6)(A) amends Subparagraph 15(b)(4)(C) by including foreign persons performing substantially equivalent functions, and Subparagraph (a)(6)(C) includes substantially equivalent foreign entities. The Act thereby clarifies the Commission's authority on this point in the same way and for the same reasons as Subsection (a)(3)(A). Subparagraph (a)(6)(B) amends Subparagraph 15(b)(4)(C) by including any foreign statute or regulation substantially equivalent to the Commodity Exchange Act, thus clarifying the Commission's authority with the same basis and purpose as Subparagraph (a)(3)(B).

Subsection (a)(7) adds new Subparagraph 15(b)(4)(G) to the Exchange Act. Subparagraph (G) empowers the Commission to base sanctions on findings by a foreign securities authority of (1) false or misleading statements in registration or reporting materials filed with the foreign securities authority, (2) violations of statutory provisions concerning securities or commodities transactions, or (3) aiding, abetting, or otherwise causing another person's violation of such foreign securities or commodities provisions, or failing to supervise a person who has committeed such a violation. Subparagraph (G) substantially parallels the provisions of existing Subparagraphs 15(b)(4) (A), (D), and (E) concerning such findings by the Commission or other securities and commodities regulatory authorities.

Section 201(b).—Subsection 201(b) of the Act amends Subsection 15(b)(6) of the Exchange Act, which authorizes the Commission to censure, limit the activities of, or bar or suspend from association with a broker or dealer any person who has committed or omitted any act or omission enumerated in Subparagraphs (A), (D), or (E), has been convicted of any offense enumerated in Subparagraph (B), or has been enjoined as specified in Subparagraph (C). By adding to Subparagraph 15(b)(6) findings by a foreign securities authority under new Subparagraph (g), Section 201(b) authorizes the Commission to consider such findings when imposing sanctions upon persons who are, or who seek to become, associated persons of a broker or dealer.

Section 201(c).—Subsection 201(c) of the Act amends Section 3(a)(39) of the Exchange Act, which concerns statutory disqualification from self-regulatory organization ("SRO") membership. Under the present statutory and regulatory scheme, a person subject to

statutory disqualification is not excluded automatically from the securities business. However, when such a person seeks to become associated with a member of an SRO, that SRO and the Commission have the opportunity, under Exchange Act Subsection 15A(g)(2) and Rule 19h-1 thereunder, to give special review to the person's employment application or to restrict or prevent reentry into the business where appropriate for the protection of investors. This structural use of statutory disqualification does not change with the Act's amendments. Rather, the amendments expand, by incorporation, the list of findings that result in statutory disqualification.

Subsection (c) amends Subparagraph 3(a)(39)(A), which now lists expulsion or suspension from membership or participation in, or association with a member of, an SRO, commodity contract market, or futures association as resulting in statutory disqualification, to include exclusion in the described manner from the foreign equivalent of an SRO, foreign or international securities exchange, or a foreign contract market, board of trade, or futures association.

Section 201(d).—As amended by Subsection 201(d), Subparagraph 3(a)(39)(B) undergoes similar expansion. It currently refers to orders of the Commission or another appropriate regulatory agency suspending or revoking registration as a broker, dealer municipal securities dealer, or government securities dealer or broker. The amendments to Subsection 3(a)(39) apply to brokers, dealers, municipal securities dealers, government securities brokers, and government securities dealers of any nationality, because these terms are defined in Exchange Act Subsections 3(a)(4), 3(a)(5), 3(a)(30), 3(a)(43), and 3(a)(44) without reference to nationality. Under Subsection 201(d), orders by an appropriate foreign financial regulatory authority, which is defined in Section 202 of the Act, denying, suspending, or revoking authority to engage in transactions in contracts of sale of a commodity for Future delivery traded and or subject to the rules of a contract market, board of trade, or foreign equivalent also will result in statutory disqualification.

Section 201(e).—Under the Act, Subparagraph 3(a)(39)(C) does not change. However, Subparagraph (D) becomes Subparagraph (E), and subsection 201(e) adds new Subparagraph (D), which includes among the conditions that result in statutory disqualification findings by a foreign or international securities exchange, foreign securities authority, or other foreign authority empowered by a foreign government to administer or enforce its laws relating to financial transactions, to the effect that an individual, by his conduct, was a cause of a suspension, expulsion, or order by the foreign securities authority or other foreign financial regulator or administrator.

Section 201(f).—Subsection 201(f) of the Act is a technical amendment that redesignates Subparagraphs 3(a)(39)(D) and (E) of the Exchange Act as 3(a)(39)(E) and (F), respectively. Subsection 201(e) of the Act necessitates these changes.

Section 201(g).—Subsection 201(g) of the Act amends redesignated Subparagraph 3(a)(39)(E) of the Exchange Act to include a reference to new Subparagraph (D).

Section 201(h).—Subsection 201(h) of the Act amends redesignated Subparagraph 3(a)(39)(F) of the Exchange Act to include a reference to new subparagraph 15(b)(14)(G) added by Subsection 201(a)(7)

of the regulatory authority" as Subsection 3(a)(51) of the Exchange Act.

Section 202.—In order to ensure that orders of any regulatory body, foreign or domestic, with authority to suspend or revoke registration or its equivalent are available to the Commission, Section 202 of the Act adds a new term, "foreign financial regulatory authority," as Subsection 3(a)(51) of the Exchange Act. A "foreign financial regulatory authority" is defined to include any foreign securities authority, which is defined in Subsection 101(a) of the Act; governmental or regulatory bodies empowered to administer or enforce laws relating to enumerated financial matters; and membership organizations that regulate members' participation in financial matters. Pursuant to the Act's amendments to Exchange Act Subsection 3(a)(39), orders of foreign financial regulatory authorities are deemed sufficient to result in "statutory disqualification," as will such an order limiting registration of the foreign equivalent of any of the enumerated entities.

Section 203.—Section 203 of the Act makes conforming amendments to various provisions of the Exchange Act. Subsections 15B(c)(2) and (4), which concern the Commission's disciplinary authority over municipal securities dealers and their associated persons, and which parallel Subsection 15(b)(4) and (6) concerning brokers, dealers, and their associated persons, are amended to include a reference to new Subparagraph 15(b)(4)(G). Findings of misconduct by a foreign securities authority thus can support Commission sanctions against municipal securities dealers and their associated persons.

Subparagraphs 15C(c)(1) (A) and (C), which concern the Commission's sanctioning authority over government securities brokers and dealers and their associated persons, and which also parallel Subsections 15(b) (4) and (6), are amended to include a reference to new Subparagraph 15(b)(4)(G), for the same reason as above.

Subparagraphs 17A(c)(3) (A) and (C), which concern the Commission's sanctioning authority over transfer agents and their associated persons, and which further parallel Subsections 15(b) (4) and (6), are amended to include a reference to new Subparagraph 15(b)(4)(G) for the same reason.

Subsection 15C(f)(2) of the Exchange Act currently forbids the Commission from investigating or taking any other action under the Exchange Act against a government securities broker or dealer or its associated persons for violations of Section 15C or the rules or regulations thereunder. The exception is where the Commission, rather than one of the banking regulators (Comptroller of the Currency for national banks, Board of Governors of the Federal Reserve System for state member banks, Federal Deposit Insurance Corporation for insured non-member state banks, and Federal Home Loan Bank Board for federally insured savings and loan associations), is the appropriate regulatory agency for the government securities broker or dealer. Subsection 15C(f)(2), by its own terms, also does not limit the Commisson's authority with respect to violations of any other provisons of the Exchange Act or of corresponding rules or regulations. Section 203 of the Act extends this prohibition by forbidding limitations on investigations pursuant to

new Exchange Act Section 21(a)(2) to assist a foreign securities authority, which are authorized by Section 101 of the Act.

Section 204.—Section 204 of the Act amends the Investment Company Act of 1940 ("1940 Act") and the Investment Advisers Act of 1940 ("Advisers Act") to clarify and strengthen the Commission's authority to impose sanctions, on the basis of violations of foreign law, on investment advisers or on persons associated or seeking to become associated with an investment adviser or a registered investment company.

Section 204(a).—Section 204(a) of the Act amends Section 9(b) of the 1940 Act. Section 9(a) of the 1940 Act generally prohibits a person convicted of a felony or misdemeanor involving securities or the securities business or subject to a temporary or permanent injunction restricting his ability to engage in the securities business from serving as an employee, officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, unit investment trust, or face-amount certificate company. The automatic statutory disqualification in Section 9(a) is supplemented by the Commission's authority under Section 9(b). Under Section 9(b), the Commission may, after notice and opportunity for hearing, prohibit a person from serving in any of the capacities cited in Section 9(a) or as an affiliated person of a registered investment company's investment adviser, depositor, or principal underwriter if the person has willfully caused a false or misleading statement to be made in any registration statement, application, or report filed with the Commission or if the person has willfully violated or willfully aided and abetted a violation of any provision (including rules and regulations) of the federal securities laws or the Commodity Exchange Act.

In an amendment parallel to Subsections 201(a)(7) and 204(b)(8) of the Act, adding Subparagraph 15(b)(4)(G) of the Exchange Act and Subsection 203(e)(7) of the Advisers Act, Section 9(b) is amended to add a new paragraph (4) that will authorize the Commission to restrict the activities of any person that has been found by a foreign authority to have (1) made any false or misleading statement in an application or report filed with a foreign securities authority or in a proceeding before the foreign securities authority, or (2) violated or aided and abetted the violation of foreign securities or commodities statutes. Paragraph (4) will, therefore, parallel the provisions of paragraph (1), (2) and (3) of Section 9(b), and extend the statute to equivalent foreign violations.

Section 9(b) also is amended to add two new subsections, 9(b)(5) and 9(b)(6), that will allow the Commission by order to prohibit a person from serving in any of the designated capacities if the person has been convicted by a foreign court of any of the offenses designated in Subsection 9 (a)(1) or has been enjoined by a foreign court in a manner set forth in Section 9(a)(2). Subsections 9(a)(1) and (a)(2) automatically disqualify anyone who within the past 10 years has been convicted of any felony or misdemeanor involving, or is subject to a permanent or temporary injunction relating to, acting as an underwriter, broker, dealer, investment adviser, municipal securities dealer, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated

person, salesman, or employee of any investment company, bank, insurance company, or entity or person required to be registered under the Commodity Exchange Act, or in connection with the purchase or sale of any security. Although a conviction or injunction under Subsections 9(a)(1) or 9(a)(2) results in an automatic statutory disqualification, a substantially equivalent foreign conviction or injunction would not. However, a substantially equivalent foreign finding will provide a basis for a Commission order prohibiting the individual's association with a registered investment company in any of the capacities designated in the statute. The automatic disqualification provisions of Section 9(a), coupled with the Commission's exemptive authority under Section 9(c) to avoid any inequitable results, are indispensable means of safeguarding the integrity of registered investment companies. The amended Section 9(b) does not automatically bar a person solely on the basis of a foreign finding of a violation of foreign law without any prior notice or opportunity for hearing by a U.S. court or administrative agency. Instead, amended Section 9(b) provides that the commission may impose a bar on a case-by-case basis if it determines that the foreign finding justifies such a sanction. The amendment does not create competitive disparities because, just as Section 9(a) applies equally to U.S. and foreign persons that have been convicted or enjoined in a manner specified in the statute, Section 9(b), as amended, grants the Commission authority to institute an administrative proceeding against either a U.S. or foreign person that has committed an equivalent foreign violation and has been sanctioned by a foreign authority.

Section 204(b).—Section 204(b) of the Act amends Section 203(e) of the Advisers Act. Section 203(e) authorizes the Commission to censure, place limitations on the activities of, suspend for up to twelve months, or revoke the registration of an investment adviser where the adviser or an associated person of the adviser has committed, or has been sanctioned for, certain specified violations. Section 204(b) of the Act amends Sections 203(e) to include, among the factors that the Commission may consider, violations of foreign law that are substantially equivalent to a violation currently set forth in the statute.

Subsection 203(e)(2) of the Advisers Act authorizes the Commission to consider convictions within the past ten years of certain felonies and misdemeanors. Subsection 204(b)(1) of the Act amends this section to include convictions by a foreign court of competent jurisdiction of crimes substantially equivalent to a felony or misdemeanor. The Act thus clarifies the Commission's authority to consider foreign criminal findings that the foreign jurisdiction may not classify as a "felony" or "misdemeanor".

Subparagraph 203(e)(2)(A) of the Act lists offenses involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense as within the class of felonies and misdemeanors that authorize the Commission to discipline investment advisers. Subsection 204(b)(2) of the Act amends Subparagraph 203(e)(2)(A) by including within this list any substantially equivalent activity, however denominated by the laws of a foreign government. The Act therefore clarifies the Commission's authority to

consider such offenses even if the relevant foreign government does not use precisely the same terminology in describing the crime as U.S. state or federal law.

Subparagraph 203(e)(2)(B) of the Advisers Act authorizes the Commission to consider offenses arising out of the conduct of various securities-related businesses. Included is any broker, dealer, municipal securities dealer, government securities broker, government securities dealer, investment adviser, bank, insurance company, fiduciary, transfer agent, or entity or person required to be registered under the Commodity Exchange Act. Subsection 204(b)(3) of the Act amends Subparagraph 203(e)(2)(B) to include offenses arising out of the conduct of any foreign person performing a function substantially equivalent to any of the above. The Act therefore clarifies the Commission's authority to consider these types of offenses regardless of the terminology used to describe the activity, which may vary among different countries.

Subparagraph 203(e)(2)(C) includes larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, and misappropriation of funds or securities within the list of offenses that may trigger Commission sanctions. Subsection 204(b)(4) of the Act adds any substantially equivalent offense, however denominated by the laws of a foreign government. Subsection (b)(4) of the Act clarifies Commission authority on this point in the same way and for the same reasons as Subsection (b)(2).

Subparagraph 203(e)(2)(D) includes violations of Sections 152, 1341, 1342, or 1343 or Chapter 25 or 47 of Title 18 of the U.S. Code within the list of offenses that the Commission may consider. These provisions concern concealment of assets, false oaths and claims, and bribery in connection with bankruptcy; mail fraud; wire fraud; counterfeiting and forgery; and fraud and false statements, respectively. Subsection 204(b)(5) of the Act amends Subparagraph 203(e)(2)(D) to include a violation of a substantially equivalent foreign statute. Subsection (b)(5) of the Act clarifies Commission authority on this point in the same manner and for the same reasons as Subsection (b)(2).

Section 203(e)(3) of the Advisers Act authorizes the Commission to impose sanctions where an investment adviser or associated person has been enjoined from acting as an investment adviser, underwriter, broker, dealer, municipal securities dealer, government securities broker, government securities dealer, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated person or employee of any investment company, bank or insurance company or entity or person required to be registered under the Commodity Exchange Act, or from engaging in any practice in connection with any of these activities or in connection with the purchase or sale of any security. Subsections 204(b)(3) and 204(b)(6) of the Act amend Subsection 203(e)(3) to include injunctions issued by any foreign court of competent jurisdiction that concern substantially equivalent activities.

Subsection 204(b)(7) of the Act is a technical amendment to Subsection 203(e)(5) of the Advisers Act. Section 203(e)(5) is amended to include violations of the Commodity Exchange Act. This technical amendment conforms Subsection 203(e)(5) with Subsection 203(e)(4)

of the Advisers Act and Subparagraphs 15(b)(4)(D) 2and 15(b)(4)(E) of the Exchange Act.

Subsection 204(b)(8) of the Act adds new Subsection 203(e)(7) to the Advisers Act. This new subsection empowers the Commission to base sanctions on findings by a foreign financial regulatory authority of (1) false or misleading statements in registration or reporting materials filed with a foreign securities authority, (2) violations of statutory provisions concerning securities or commodities transactions, or (3) aiding, abetting, or otherwise causing another person's violation of such foreign securities or commodities provisions, or failing to supervise a person who has committed such a violation. Subsection (e)(7) substantially parallels the provisions of existing Subsections 203(e) (1), (4) and (5) concerning such findings by the Commission or other securities and commodities regulatory authorities. This section of the Act parallels Sections 201(a)(7) and 204(a) of the Act, which add Subsection 15(b)(4)(7) of the Exchange Act and Section 9(b)(4) of the 1940 Act.

Section 204(c).—Section 204(c) of the Act amends Section 203(f) of the Advisers Act, which authorizes the Commission to impose sanctions upon persons associated or seeking to become associated with an investment adviser if the person has committed or omitted any act or omission set forth in Subsection 203(e)(1), (4) or (5) or has been convicted or enjoined as set forth in Subsections 203(e)(2) or 203(e)(3). Section 203(f) is amended to include a reference to new Subsection 203(e)(7), thus authorizing the Commission to consider such findings when imposing sanctions upon persons who are, or seek to become, associated with an investment adviser.

Section 205.—Section 205 amends Section 2(a) of the 1940 Act and Section 202(a) of the Advisers Act to include definitions of "foreign securities authority" and "foreign financial regulatory authority". A "foreign securities authority" is defined as "any foreign government, or any government body or regulatory organization empowered by a foreign government to administer or enforce its laws relating to securities." A "foreign financial regulatory authority" includes a " foreign securities authority" or organization that is essentially equivalent to a self-regulatory organization. These definitions are identical to the definitions added to the Exchange Act by Subsection 101(a) and Section 202 of the Act.

Section 301.—The report required by Section 301 is intended to prompt the SEC to evaluate the success of its international enforcement efforts. The Committee respects the SEC's judgment that it can improve international enforcement of U.S. securities laws through greater cooperation with foreign authorities. However, the Committee recognizes that in the complex international securities market, changes in enforcement are likely to prompt changes in the marketplace. Improved enforcement of U.S. securities law in some foreign jurisdictions and improved enforcement of those foreign jurisdiction's laws in the U.S. may cause those who conduct legally questionable foreign-source trading to shift their trading to a jurisdiction less cooperative with other jurisdictions. Among unscrupulous traders there is an obvious value to lax enforcement. There is also market value attached to bank privacy for certain legitimate traders. Better enforcement jursidictions thus may have the consequence of promoting a flight of foreign-source transactions

to jurisdictions which provide greater privacy and greater insulation for the enforcement of the enforcement of foreign securities laws.

The report requires the SEC to periodically evaluate the effect of improved international enforcement on the international securities market and the net effect on the market for U.S. securities. In effect, this bill endorses an SEC enforcement strategy based on cooperation. In the context of the report required herein, the SEC should examine its decision to pursue this enforcement strategy and evaluate all available data to determine whether its resources are best spent in pursuit of this strategy.

Regulatory Impact Statement

The Committee has evaluated the regulatory impact of the legislation pursuant to rule XXVI, paragraph 11(b) of the Standing Rules of the Senate, and concludes that the legislation would not appreciably increase the regulatory burden imposed by the Government.

Cost of Legislation

Pursuant to section 403(a) of the Congressional Budget Act of 1974, the Committee has requested the Congressional Budget Office to estimate the cost of carrying out the legislation. That estimate appears below.

U.S. Congress,
Congressional Budget Office,
Washington, DC, August 5, 1988.

Hon. William V. Proxmire,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 2544, the International Securities Enforcement Cooperation Act of 1988, as ordered reported by the Senate Committee on Banking, Housing and Urban Affairs, July 27, 1988.

Based on information from the Securities and Exchange Commission (SEC), we expect that enactment of S. 2544 would not result in significant additional cost to the federal government. The bill contains a number of provisions aimed at facilitating cooperation between the United States and foreign countries in securities law enforcement. Specifically, the bill would give the SEC the authority to provide investigatory assistance at the request of a foreign country, provided that country grants reciprocal assistance to the SEC. In addition, the bill would permit the SEC to consider misconduct by securities professionals in foreign countries as a basis for restricting the activities of such professionals in the U.S. securities industry.

No costs would be incurred by state or local governments as a result of enactment of this bill.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Douglas Criscitello, who can be reached on 226–2850.

Sincerely,

JAMES L. BLUM,
Acting Director.

CHANGES IN EXISTING LAW

The Committee has determined that it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of rule XXVI, paragraph 12 of the Standing Rules of the Senate.

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Calendar No. 905

100TH CONGRESS *2d Session*	SENATE	REPORT 100-483

THRIFT CHARTER ENHANCEMENT ACT OF 1988

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2073

AUGUST 11 (legislative day, AUGUST 10), 1988.—Ordered to be printed

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U.S. GOVERNMENT PRINTING OFFICE

19-010 WASHINGTON : 1988

S243-8

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Calendar No. 905

100TH CONGRESS
2d Session

SENATE

REPORT
100-483

THRIFT CHARTER ENHANCEMENT ACT OF 1988

AUGUST 11, (legislative day, AUGUST 10), 1988.—Ordered to be printed

Mr. PROXMIRE, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 2073]

INTRODUCTION

The Committee on Banking, Housing, and Urban Affairs, to which was referred the bill S. 2073 entitled the "Thrift Charter Enhancement Act of 1988," reports favorably thereon with an amendment and recommends that the bill as amended do pass.

PURPOSE OF THE LEGISLATION

The bill is intended to make thrift charters more attractive and thereby encourage investment in thrift institutions and reduce the cost to the Federal Saving and Loan Insurance Corporation of dealing with failed or failing institutions.

HISTORY OF THE LEGISLATION

The bill was introduced by Senator Karnes on February 18, 1988.

On April 27, the Committee held a hearing on the bill. The witnesses were: the Honorable Charles O. Sethness, Assistant Secretary for Domestic Finance, Department of the Treasury; the Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board; Mr. Charles John Koch, First Vice Chairman, National Council of Savings Institutions; Mr. William A. Cooper, Director, Association of Thrift Holding Companies; and Mr. J.R. Nunn, President, Independent Bankers Association of America.

On July 27, the Committee met and, by voice vote, ordered the bill reported to the Senate with an amendment. The amendment deletes 13 of the 18 sections of the bill, and substantially revises most of the remaining sections.

SUMMARY OF THE LEGISLATION

Section 2 liberalizes the current restrictions on transactions between thrift institutions and their affiliates. The liberalization is available to any thrift institution that is "GAAP-qualified", as defined in the bill: namely, one that (1) has 5 percent capital (as capital is determined under section 2) and meets any minimum capital standard prescribed by FSLIC, and (2) is not affiliated with an undercapitalized thrift institution. (There is an exception for affiliations that result from the acquisition of a failed or failing institution if that institution's capital has been brought up to at least zero, and that institution is implementing a FSLIC-approved plan for raising its capital to 3 percent within four years after the acquisition.) GAAP-qualified thrift institutions are unlikely to be a source of abuses or other problems.

Under current law, a thrift institution needs FSLIC's approval if certain of its transactions with affiliates exceed the *lesser* of $100,000 or 0.1 percent of the institution's total assets. For GAAP-qualified institutions, section 2 raises the limit to the *greater* of $100,000 or 0.1 percent of total assets. But FSLIC's approval is still required if transactions involving the purchase, sale, or lease of assets would exceed $2 million, or if agreements for services would exceed $1 million. Current law will continue to apply to thrift institutions that are not GAAP-qualified.

Section 3 permits thrift holding companies to acquire up to 5 percent of the voting shares of an unaffiliated thrift institution or thrift holding company. Such acquisitions are prohibited under current law.

Section 4 repeals a provisions that prohibits an officer, director, or controlling shareholder of a thrift holding company from serving as a director, officer, or employee of an unaffiliated thrift institution or thrift holding company.

Section 5 permits a thrift holding company to incur debt without FSLIC's prior approval if each thrift institution controlled by the holding company is GAAP-qualified (as defined in section 2 of the bill). There is an exception for thrifts acquired as failed or failing institution.

SECTION-BY-SECTION ANALYSIS

Section 1. Short title

This section designates the bill as the "Thrift Charter Enhancement Act of 1988."

Section 2. Affiliate transactions

Section 408(d)(6) of the National Housing Act requires a federally insured thrift institution that is controlled by a savings and loan holding company to obtain FSLIC's written approval before:

(1) engaging in any transaction with any affiliate involving the purchase, sale, or lease of property or assets (other than certain interests in mortgage loans) if the consideration involved—when added to the aggregate amount of the consideration given or received by the thrift institution for all such transactions during the preceding 12 months—exceeds the

lesser of $100,000 or 0.1 percent of the thrift institution's total assets at the end of the preceding fiscal year;

(2) entering into any agreement or understanding with any affiliate under which the affiliate is to render management, advertising, consulting, or other services for the thrift institution, if the aggregate amount of the consideration that the thrift institution could be required to pay in the future under all existing agreements or understandings could exceed the *lesser* of $100,000 or 0.1 percent of total assets; or

(3) making any payment to an affiliate under any agreement or understanding referred to in paragraph (2) if, during the preceding 12 months, the thrift institutions's aggregate payments to its affiliates pursuant to such agreements or understandings exceed the *lesser* of $100,000 of 0.1 percent of total assets.

12 U.S.C. § 1730a(d)(6).

A. Increased threshold for transactions without FSLIC's Approval

This section liberalizes the restrictions of section 408(d)(6) for "GAAP-qualified" thrift institutions—institutions that (as discussed below) are adequately capitalized and have no undercapitalized affiliates. In the case of a GAPP-qualified institution, the transaction threshold above which FSLIC's prior written approval is required will be the *greater* (rather than the lesser) of $100,000 or 0.1 percent of total assets—except that FSLIC's approval is still required if transactions involving the purchase, sale, or lease of property or assets (paragraph (1) above) would exceed $2 million, or if agreements for services (paragraphs (2) and (3) above) would exceed $1 million. Thrift institutions that are not GAAP-qualified will continue to be subject to the current threshold: i.e., the *lesser* of $100,000 or 0.1 percent of total assets.

In liberalizing the prior-approval requirement of section 408(d)(6) for GAAP-qualified thrift institutions, this section does not limit FSLIC's current discretion to approve transactions under section 408(d)(6) even if the thrift institution in question is not GAAP-qualified. Likewise, this section does not limit FSLIC's current authority to act against transactions that are unsafe or unsound.

B. Definition of GAAP-qualified thrift institution

This section uses the term "GAPP-qualified insured institution" to delineate a class of federally insured thrift institutions that are sufficiently well capitalized that they are unlikely to be a source of abuses or other problems.

For purposes of determining whether a thrift institution is GAAP-qualified, capital is determined under accounting standards prescribed by FSLIC under section 415 of the National Housing Act (12 U.S.C. § 1730h) ("GAAP-related accounting standards"), but taking into account only those elements of capital that are consistent with generally accepted accounting principles ("GAAP"), with accounting standards applied by the Federal bank regulatory agencies, or with other standards specifically made applicable to insured institutions by Federal statute.

A thrift institution is "GAAP-qualified" if it meets a two-part test. First, its capital under GAAP-related accounting standards

must equal or exceed 5 percent of total assets or the minimum capital level prescribed by FSLIC, whichever would result in a higher capital level. Second, it must not be affiliated with a federally insured thrift institution whose capital is less than 3 percent of total assets under GAAP-related accounting standards. There is an exception for affiliations that result from the acquisition of a failed or failing institution if: (1) the acquired institution's capital under GAAP-related accounting standards is increased to at least zero; (2) the institution has submitted a plan for increasing its capital to at least 3 percent of total assets within four years after the acquisition; (3) FSLIC has determined the plan to be feasible; and (4) the institution is in compliance with the plan.

Section 415 of the National Housing Act, which was added by section 402(b) of the Competitive Equality Banking Act of 1987 ("CEBA"), requires FSLIC to prescribe uniformly applicable accounting standards that must, subject to three specific exceptions, be consistent with GAAP. The first class of exceptions arises to the extent that the Federal bank regulatory agencies' accounting standards deviate from GAAP. In such cases, FSLIC may "choose whether to adopt the same deviations or to follow GAAP." S. Rep. No. 19, 100th Cong., 1st Sess. 55 (1987). The second class comprises exceptions specifically authorized or required by subsections (b)(2), (d), or (e) of section 415 (notably the treatment of subordinated debt, goodwill, and certain loan losses) or by other Federal statutes (e.g., net worth certificates). The third class may arise to the extent that FSLIC grants extensions of time for compliance under section 402(d) of CEBA. Exceptions under the third class would not be available for determining compliance with GAAP-related accounting under this Act.

The reference in this section to "[c]apital . . . defined . . . pursuant to section 415 of the National Housing Act" includes the identical definition of capital pursuant to section 9 of the Home Owners' Loan Act of 1933. 12 U.S.C. § 1467.

Section 3. Investments by savings and loan holding companies in unaffiliated thrift institutions

Section 408(e)(1)(A)(iii) of the National Housing Act prohibits a savings and loan holding company from acquiring any voting shares of a federally insured thrift institution—or a savings and loan holding company—that is not a subsidiary of the would-be acquirer. 12 U.S.C. § 1730a(e)(1)(A)(iii). Thus a savings and loan holding company may not currently acquire voting shares of another savings and loan holding company or of a federally insured thrift institution unless it has, or is acquiring, control of that holding company or thrift institution.

This section permits a savings and loan holding company to acquire up to 5 percent of the outstanding voting shares of a federally insured thrift institution or a savings and loan holding company, even if the acquirer does not control the thrift institution or holding company that is the issuer of the shares.

Bank holding companies already have similar authority under section 4(c)(6) of the Bank Holding Company Act of 1956. 12 U.S.C. § 1843(c)(6).

Section 4. Interlocking Directors of Savings and Loan Holding Companies

Section 408(i)(2)(A) of the National Holding Act prohibits a director, officer, or controlling shareholder of a savings and loan holding company from serving at the same time—without FSLIC's prior approval—as a director, officer, or employee (1) of a federally insured thrift institution that is not a subsidiary of that savings and loan holding company, or (2) of a savings and loan holding company that is not a subsidiary of that savings and loan holding company. 12 U.S.C. § 1730a(i)(2)(A).

These restrictions, enacted in 1968, have now essentially been superseded by the Depository Institution Management Interlocks Act of 1978, a comprehensive statute applicable to all depository institutions. The Interlocks Act restricts management officials of a depository institution (including a thrift institution) or depository holding company (including a savings and loan holding company) from serving as managment officials of certain unaffiliated depository institutions or depository holding companies. 12 U.S.C. §§ 3201–04. "Management official" includes a director and "an employee or officer with management functions". *Id.* § 3201(4).

This section repeals section 408(i)(2)(A), leaving the Interlocks Act as the standard governing management interlocks.

Section 5. Debt Approval

Section 408(g)(1) of the National Housing Act generally forbids a savings and loan holding company or any nonthrift subsidiary of such a holding company to "issue, sell, renew, or guarantee any debt security of such company or subsidiary, or assume any debt," without FSLIC's prior approval. 12 U.S.C. § 1730a(g)(1). But the prohibition does not apply (1) to a diversified savings and loan holding company or its subsidiaries, or (2) to a transaction that, when aggregated with all outstanding securities and debt on which the holding company or subsidiary is primarily or contingently liable, does not exceed 15 percent of the consolidated net worth of the holding company or subsidiary at the end of the preceding fiscal year. *Id.* § 408(g)(2).

This section creates an additional exemption from the prior approval requirement of section 408(g)(1). The exemption is available to any savings and loan holding company and its subsidiaries if each federally insured thrift institution controlled by that savings and loan holding company (1) is GAAP-qualified (as defined in section 2(c) of the bill), or (2) was acquired as a failed or failing institution, has capital of at least zero under GAAP-related accounting standards, and is implementing a FSLIC-approved plan to increase its capital (all as provided in section 408(a)(1)(M)(iii) of the National Housing Act, added by section 2(c) of the bill).

In creating the exemption, this section does not limit FSLIC's current discretion to approve transactions under section 408(g)(1) even if a subsidiary thrift institution of the holding company in question is not GAAP-qualified. Likewise, this section does not limit FSLIC's current authority to act against transactions that are unsafe or unsound.

Regulatory Impact Statement

The Committee evaluated the regulatory impact of the bill pursuant to rule XXVI, paragraph 11(b) of the Standing Rules of the Senate, and concludes that the bill does not increase the regulatory burden imposed by the Government.

Changes in Existing Law

The Committee has determined that it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of rule XXVI, paragraph 12 of the Standing Rules of the Senate.

Cost of Legislation

Pursuant to section 403(a) of the Congressional Budget Act of 1974, the Committee has requested the Congressional Budget Office to estimate the cost of carrying out the bill. That estimate appears below:

U.S. Congress,
Congressional Budget Office,
Washington, DC, August 2, 1988.

Hon. William Proxmire,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Sentate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 2073, the Thrift Charter Enhancement Act of 1988, as ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on July 27, 1988. We expect that enactment of this bill would result in no significant cost to the federal government, and in no cost to state or local governments.

S. 2073 would allow federally insured thrift institutions, under certain circumstances, to conduct a number of transactions involving the purchase, sale, or lease of property or assets without the approval of the Federal Savings and Loan Insurance Corporation. It would also expand the type of investments that savings and loan holding companies could make in unaffiliated thrift institutions, and make a number of other changes.

Based on information from the Federal Home Loan Bank Board, the cost of issuing regulations to carry out these provisions is not expected to be significant. Any expenses associated with additional supervision and enforcement would be incurred by the Federal Home Loan Bank system, whose spending is not included in federal budget totals.

If you wish further details on this estimate, we would be pleased to provide them. The CBO staff contact is Mary Maginniss, who can be reached at 226–2860.

Sincerely,

James L. Blum, *Acting Director.*

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